

	A97467	19991106	1001274930	\$75.77
	A99834	19991206	1001335731	\$47.17
716Y400050615	AA3599	20000104	1001399733	\$737,580.07
716Y400050615	AA6157	20000130		\$(5.69)
716Y400050615	AB1052	20000204	1001517045	\$915,108.58
716Y400050615	AB3803	20000304	1001584973	\$992,463.26
716Y400050615	AB6820	20000404	1001650311	\$1,059,459.78
716Y400050615	A75917	19990604	1000958086	\$105,910.66
716Y400050615	A84525	19990704	1001029804	\$168,228.14
716Y400050615	A85408	19990804	1001077099	\$201,611.63
716Y400050615	A89868	19990904	1001204307	\$255,497.59
716Y400050615	A92639	19991004	1001215747	\$303,420.47
716Y400050615	A95237	19991104	1001258950	\$384,571.05
716Y400050615	A98142	19991204	1001323949	\$522,766.52
716Y400050615	W46633	19990304	1000624021	\$1,488.68
716Y400050615	W48788	19990404	1000764809	\$6,200.17
716Y400050615	W50027	19990504	1000801346	\$65,307.23
	AA3600	20000104	1001399733	\$44,089.77
	AB1053	20000204	1001517045	\$58,285.69
	AB3802	20000304	1001584973	\$63,441.39
	AB7744	20000404	1001650311	\$68,170.11
	A75972	19990604	1000956513	\$4,420.86
	A84568	19990704	1001029804	\$12,432.40
	A85412	19990804	1001077099	\$13,096.30
	A89869	19990904	1001204307	\$15,852.18
	A92638	19991004	1001215747	\$19,253.07
	A95244	19991104	1001301637	\$23,579.54
	A98143	19991204	1001323949	\$34,848.68
	W46632	19990306	1000624021	\$92.54
	W48786	19990404	1000764809	\$151.46
	W50031	19990504	1000801346	\$1,980.23
617K400000753	AA3449	20000104	1001399733	\$69,805.48
617K400000753	AB1054	20000204	1001517045	\$69,805.48
617K400000753	AB3796	20000304	1001584973	\$69,805.48
617K400000753	AB7093	20000404	1001646108	\$69,805.48
617K400000753	A75946	19990604	1000956513	\$69,805.48
617K400000753	A84567	19990704	1001029804	\$69,805.48
617K400000753	A84969	19990404	1001032792	\$69,805.48
617K400000753	A85375	19990804	1001077099	\$77,484.07
617K400000753	A89863	19990904	1001215747	\$70,183.65
617K400000753	A92117	19991004	1001215747	\$70,037.93
617K400000753	A95243	19991104	1001255050	\$70,858.23
617K400000753	A98144	19991204	1001323949	\$70,121.02
617K400000753	W50037	19990504	1000801346	\$1,681,570.12
914M40000021	A75947	19990604	1000956513	\$5.71
9				
914M40000021	A84557	19990704	1001029804	\$5.53
9				
914M40000021	A85637	19990804	1001077099	\$380.74
9				
914M40000021	A90780	19990904		\$-
9				
914M40000021	W43421	19990204		\$-
9				
914M40000021	W45508	19990304	1000624021	\$24.62
9				

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W48051

19990404

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W50040

19990504 1000801346

\$5.53



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**Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

In the Matter of)	
)	
Application by Verizon New England Inc.,)	
Bell Atlantic Communications, Inc.,)	
(d/b/a Verizon Long Distance), NYNEX)	CC Docket No. 00-176
Long Distance Company (d/b/a Verizon)	
Enterprise Solutions), and Verizon Global)	
Networks Inc., for Authorization to Provide)	
In-Region, InterLATA Services in Massachusetts)	

DECLARATION OF A. DANIEL KELLEY

Table of Contents

I. Qualifications	4
II. Public Policy Prerequisites for Bell Company Entry	5
III. Local Competition Is Not Well-Developed in Massachusetts.....	6
IV. Barriers to Local Facilities-Based Entry	10
V. UNE Pricing Precludes LOCAL OR Bundled Service Competition.....	15
A. Prerequisites for UNE Competition	16
B. UNE Pricing in Massachusetts.....	18
C. A Comparison of Massachusetts with New York and Texas UNE Competition	19
VI. Anticompetitive Behavior.....	21
VII. Long Distance Competition.....	27
VIII. Path Dependency and Verizon Long Distance Entry.....	28
IX. Conclusion	29
Attachment 1	
Attachment 2	
Attachment 3	

**Declaration of
A. Daniel Kelley**

1. I have been asked by WorldCom, Inc. to respond to the Declaration filed by Dr. William E. Taylor in support of Verizon's section 271 Application for the Commonwealth of Massachusetts. Dr. Taylor claims that Verizon entry will enhance competition for local, long distance, and bundled services especially to residential consumers. He is wrong on all three counts:

- Local competition is not well developed today, particularly for residential mass-market customers. Verizon entry into the long distance business will do nothing to alter this fact. The current lack of local competition is due to economics, technology, and historical delays in meaningful unbundling of Verizon's network.
- Competition to provide bundled local and long distance service, as well as stand-alone local service, depends on the availability of the unbundled network element platform ("UNE-P"). However, the UNE-P in Massachusetts is priced far above economic cost. Therefore, local competitors are not in a position to economically offer bundled services to mass market customers. In these circumstances, Verizon entry into long distance cannot possibly stimulate bundled service competition. The advantage that premature entry will give Verizon will lead to reduced bundled service competition.
- The long distance market is already highly competitive, and Verizon entry will add little to that market. Prices have fallen and consumers can choose from among a wide variety of competitive pricing plans today.

Dr. Taylor also argues that Verizon will not behave anticompetitively in the long distance market. He bases this conclusion on experience in other markets as well as on the existence of regulatory safeguards. Again he is incorrect. The experience he cites in other markets is either inapplicable to the long distance market or proves the opposite. If regulation could prevent a BOC from impeding long distance competition if it began to provide long-distance service while its local markets were still closed, then Congress would not have found it necessary to make open local markets a precondition to in-region

entry. I conclude that Verizon entry into the long distance market would not be in the public interest.

2. My qualifications are summarized in Section I. Section II is a discussion of the public interest prerequisites for Bell company entry into the interLATA market. Section III describes the current state of local competition in Massachusetts and explains why Verizon long distance entry will not change the dynamics. Section IV discusses barriers to facilities-based competition in Massachusetts. Problems with unbundled network element (“UNE”) pricing in Massachusetts are described in Section V. Section VI discusses anticompetitive behavior. Section VII discusses long distance competition. Section VIII explains why competition in local, long distance, and bundled services will be impaired if Verizon is granted premature entry. The Declaration concludes in Section IX.

I. Qualifications

3. My current position is Senior Vice President of HAI Consulting, Inc. (formerly Hatfield Associates, Inc.). My professional experience began in 1972 at the Antitrust Division of the U.S. Department of Justice where I analyzed mergers, acquisitions and business practices in a number of industries, including telecommunications. While at the Department of Justice, I was a member of the U.S. v. AT&T economics staff. In 1979, I moved to the Federal Communications Commission (“FCC”) where I held several positions, including Special Assistant to the Chairman, Senior Economist in the Policy and Rules Division of the Common Carrier Bureau and Senior Economist in the Office of Plans and Policy. After leaving the FCC, I was a Project Manager and Senior Economist at ICF, Incorporated, a public policy consulting

firm. From September 1984 through July of 1990, I was employed by MCI Communications Corporation as its Director of Regulatory Policy.

4. In my present position, I conduct economic and policy studies on a wide variety of telecommunications issues, including local competition, dominant firm regulation, and the cost of local service. I have prepared economic studies of the wireless industry and have analyzed several telecommunications mergers. I have advised foreign government officials on telecommunications policy matters and have taught seminars in regulatory economics in a number of countries.

5. I have testified on telecommunications issues before the California, Colorado, Connecticut, Florida, Georgia, Hawaii, Maryland, Massachusetts, Michigan, Oregon, Pennsylvania, Utah and Washington Commissions, as well as the FCC and the Federal-State Joint Board investigating universal service reform.

6. I received a Bachelor of Arts degree in Economics from the University of Colorado in 1969, a Master of Arts degree in Economics from the University of Oregon in 1971, and a Ph.D. in Economics from the University of Oregon in 1976. My resume is in Attachment 1.

II. Public Policy Prerequisites for Bell Company Entry

7. The Bell Operating Companies ("BOCs") are prohibited by the Telecommunications Act of 1996 ("1996 Act" or "Act") from providing interLATA long distance service in their in-region states unless they can demonstrate that they have effectively and irreversibly opened their local markets to competition.¹ The underlying public policy objectives of these provisions of the Act are both to provide an incentive to

¹ Communications Act of 1934, as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("Act"), 47 U.S.C. §§ 151 *et seq.*, § 271.

open the local markets in the first place, and to help ensure that long distance markets remain competitive after the BOCs re-enter. The concern about maintaining long-distance competition despite BOC entry is a reasonable and substantial one. When BOCs provided long distance through the integrated Bell System, they used a variety of anticompetitive tactics to prevent, delay or reduce long distance competition.² Moreover, many consumers have a preference for bundled local and long distance offerings. Consumers will be harmed if the BOC is the only carrier in a position to offer such a service, even though competition to provide local service could develop if the necessary preconditions were created.³

III. Local Competition Is Not Well-Developed in Massachusetts

8. Table 1 shows the extent of facilities-based local competition in Massachusetts. These estimates are based on Dr. Taylor's estimates of the number of lines that competitive local exchange companies ("CLECs") provide using their own facilities. I adjusted his estimates by removing unbundled loops ("UNE-L") because those facilities are not under CLEC control. In order to provide service over an unbundled loop, the CLEC must lease both collocation space in the incumbent local exchange company ("ILEC") central office and the actual loop. Thus, entrants using loops to compete with Verizon are highly dependent on Verizon pricing and provisioning and, therefore, are not true facilities-based competitors. In any event, as discussed below, only a small number of UNE-L lines have been sold. I estimated the total Verizon lines using the methodology described in Attachment 2.

² U.S. v AT&T, 552 F. Supp. 131, 160-163 (1982) (Modification of Final Judgment).

³ See, Beard, T. Randolph, Kaserman, David L. and Mayo, John W., "Monopoly Leveraging, Path Dependency, and the Case for a Local Competition Threshold for BOC Entry into InterLATA Toll," Michael A. Crew, ed., Regulation Under Increasing Competition, Kluwer Publishing, Boston, MA 1999.

Table 1 CLEC Facilities Penetration	
Area Code	
617 (Boston)	12.1%
781 (Revere)	8.3%
978 (Danvers)	4.9%
508 (Plymouth)	2.6%
413 (Springfield)	1.4%
Total	6.2%

Table 1 shows that penetration is greatest in the greater Boston area (NPAs 617 and 781) and then falls off in the less densely populated areas of the state. Combining the two Boston area NPAs results in a 10.3 percent share, while the share in the remainder of the state is only 3.1 percent. The statewide numbers are consistent with long distance minutes terminated by WorldCom to CLECs in Massachusetts. According to information provided to me by WorldCom, in August of this year only 7.345 percent of the minutes on WorldCom's long distance network were terminated to CLEC customers.

9. Most of the competition is for business lines. Dr. Taylor reports that there are only 84,000 facilities-based residential directory listings (excluding platforms) for lines provided by competitors,⁴ which represents sales by AT&T and RCN in limited portions of the state. RCN primarily serves apartment buildings in the Boston area.⁵ I estimate that Verizon has approximately 2.9 million residential lines. Therefore, residential penetration is only 2.8 percent.⁶

10. UNE competition is extremely limited in Massachusetts. As Table 2 shows, only a minuscule fraction of business and residential lines are being provisioned to

⁴ Taylor Decl., Attachment A, Exhibit 2.

⁵ See RCN Form 10K for fiscal year ended December 31, 1999, p. 2.

⁶ Based on Taylor's estimate of residential penetration and my estimate of Verizon residential lines.

competitors using the UNE-P.⁷ As Table 3 shows, unbundled loop penetration generally is slightly higher, but still quite low, especially outside the greater Boston area.

Table 2 UNE-P Penetration	
Area Code	UNE-P
413 (Springfield)	0.7%
508 (Plymouth)	0.2%
617 (Boston)	0.1%
781 (Revere)	0.1%
978 (Danvers)	0.1%
Total	0.2%

Table 3 UNE-L Penetration	
Area Code	
413 (Springfield)	0.3%
508 (Plymouth)	0.4%
617 (Boston)	1.4%
781 (Revere)	0.8%
978 (Danvers)	0.5%
Total	0.7%

11. Resale is also relatively undeveloped in Massachusetts. Table 4 shows that resale penetration is less than five percent throughout the state. This low penetration is despite the fact that resale discounts in Massachusetts are more reasonable than the discounts established in many other states because the Massachusetts DTE followed the Commission's resale rules more closely than the other states.⁸ Resale is little used because it is an inferior means to reach customers. The 24.99 percent discount in Massachusetts, while larger than that in many other states, does not allow a sufficient

⁷ Z-Tel is offering a high-end niche product using UNE-P that is not intended for most consumers.

⁸ See Before Commonwealth of Massachusetts, Department of Public Utilities, Consolidated Petitions of New England Telephone and Telegraph, Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration of Interconnection Agreements, D.P.U., 96-73/74, 96-75, 96-80/81, 96-83, 96-94—

margin for mass marketing.⁹ Neither WorldCom nor AT&T, which Dr. Taylor identifies as the two largest CLECs, is relying on resale in Massachusetts or any other state. Most of the companies that resell local service focus on business customers or narrow residential niches.¹⁰ Moreover, resale does not provide long distance carriers with the flexibility over service design that is afforded by the UNE-P. Resale limits a competitor to selling retail customers the features and functions available in the ILEC offerings, but UNE-P enables a CLEC to customize the local offering.

Table 4 Resale Penetration	
Area Code	Resold
413 (Springfield)	4.4%
508 (Plymouth)	3.6%
617 (Boston)	4.6%
781 (Revere)	4.3%
978 (Danvers)	3.8%
Total	4.1%

12. Dr. Taylor's claim that "competitors in Massachusetts are providing service to both residential and business customers across the state using each of the three paths of competitive entry contemplated by the 1996 Act . . ."¹¹ may be literally correct. However, a closer look at the data shows that Verizon remains overwhelmingly dominant in all parts of the state. For businesses outside of the greater Boston area and for residential customers throughout the state, facilities-based competitors can be described as barely gaining a toe-hold.

Phase 2, Phase 2 Order, December 3, 1996. Unfortunately, as discussed below, the Massachusetts DTE did not carefully follow the Commission's requirements for establishing UNE Rates.

⁹ The 24.99 percent discount is for the case where Verizon provides operator services. See New England Telephone and Telegraph Company, Rates and Charges Effective in the Commonwealth of Massachusetts, section 10.55.

¹⁰ For example, some resellers offer local service at a premium over incumbent rates to customers with poor credit history.

13. If Verizon is granted section 271 authority with the current level of local competition, it will have a significant competitive advantage in competing for the business of the vast majority of residential customers in the state that do not have a readily available competitive alternative. However, Dr. Taylor claims that granting section 271 authority to Verizon will actually stimulate more local facilities competition because “. . . long distance carriers will have an increased incentive to compete vigorously for mass-market local exchange services.”¹² The reality is that there are economic and technical barriers to local competition that will be unaffected by Verizon entry into the long distance market. In addition, the key current barriers to local competition for mass market customers are ones over which Verizon itself has control. Allowing Verizon to enter the long distance market prior to reducing these barriers makes it even less likely that competitors will be able to successfully enter and grow. Barriers to the expansion of local competition are discussed below.

IV. Barriers to Local Facilities-Based Entry

14. There are three means of facilities-based entry – fiber rings, cable telephony and wireless.

15. Fiber Rings. As in other states, competitors have built local fiber ring facilities in major metropolitan areas. Based on the estimates discussed above, there is a moderate amount of competition for business customers in the Boston area. However, fiber rings do not provide a cost-effective means for reaching customers in areas with lower line densities. The residential and business customers that populate these areas often spend less on telecommunications. At the same time it costs more to serve them

¹¹ Taylor Decl., Attachment A, p. 1.

because economies of scale in transmission are not available. This higher cost makes it very unlikely that competitors will build or extend fiber rings to serve customers outside of areas with large concentrations of business lines. In fact, even within these areas it is expensive for fiber ring competitors to expand to serve additional buildings, including single-family dwellings.¹³

16. It may be possible for fiber ring networks to efficiently expand by attracting customers through the UNE-P or UNE-L and then building out their networks when sufficient demand exists. This expansion path is less attractive in Massachusetts because, as discussed below, unbundled network elements are so overpriced.

17. Wireless. Wireless has great promise as a competitive alternative. However, a comparison of pricing of wireless services with wireline services offered by Verizon shows that mobile and fixed services are not yet effective substitutes. On average, the wireless plans available in Massachusetts cost more than twice as much as Verizon's residential wireline service, even when wireless rate plans are matched to typical residential usage plans.¹⁴ Moreover, wireless signal quality is not as good as wireline signal quality. There are, of course, some users who may choose to rely on a mobile phone for all of their needs. However, the combination of higher prices, lower quality, the calling-party-pays system, and the lack of directory services makes mobile services a poor substitute for local services today.

18. Fixed wireless has some promise as well. As Dr. Taylor notes, WorldCom is implementing a trial of MMDS service in Boston. However, WorldCom is currently able

¹² *Ibid.*, p. ii.

¹³ Hatfield Associates, Inc., The Enduring Local Bottleneck II, Boulder, CO, April 30, 1997.

to offer only Internet access service over MMDS, not voice service. It will be some time before fixed wireless can be considered a viable substitute for Verizon's local wireline services. Constructing facilities will necessarily take substantial time, and the quality of voice over IP must be enhanced.

19. Cable Telephony. Cable telephony offers another potential alternative to Verizon's local services. This alternative is significant for residential competition because cable companies serve primarily residential areas. Compared to many other states, Massachusetts is relatively well positioned for cable telephony competition. AT&T, which has made a public commitment to cable telephony, is by far the largest cable operator in the state. Compared to other cable systems (including many of the former TCI systems now owned by AT&T), the MediaOne systems that AT&T acquired are relatively well positioned for cable telephony because most of them have been upgraded to provide two-way capability, although not necessarily to provide telephone services. However, even in Massachusetts, the potential for cable telephony is far from being realized.

20. Less than three percent of the residential lines in Massachusetts are served through cable telephony. As a result, cable telephony currently plays only a minor competitive role in Massachusetts. The potential significance of future competition rests on two factors: (1) the ability of AT&T to attract customers where its cable telephony service is now available; and (2) the extent and speed with which cable telephony can be made available where it is not currently available.

¹⁴ Based on HAI comparisons of wireless and Verizon pricing plans. Short term wireless promotions were excluded.

21. Inducing local exchange customers to substitute cable telephony for Verizon service presents a challenge to AT&T, like other cable operators. The local telephone service provided by Verizon generally works well and is offered at regulated prices. In general, cable television networks were never engineered to provide the reliability of the public switched telephone network. Although AT&T and other operators providing cable telephony services are presumably building high quality systems, they must still contend with a reputation built on consumer experience with their cable television service – and customer expectations of high quality and reliability for telephone service they consider essential in their daily lives. Thus, building significant telephony market share using cable systems is likely to prove difficult.¹⁵

22. The difficulties in gaining cable telephony market share are illustrated by the fact that AT&T's residential market share is quite small despite the fact that its prices in Massachusetts are substantially below those of Verizon.¹⁶ Indeed, AT&T was recently forced to announce a promotion offering free service for up to five months for new cable telephony subscribers. One analyst noted that this expensive promotion demonstrated the difficulty AT&T was having in building market share.¹⁷

23. AT&T offers cable telephony to at most one-third of the households in the state.¹⁸ Cable operators other than AT&T are not offering cable telephony in

¹⁵ See, Economics and Technology, Inc. and Hatfield Associates, Inc., The Enduring Local Bottleneck, Boston, MA, 1994, Section 4. The barriers cable operators must overcome in building telephony market share that are discussed in Section 4 remain the same today as they were when The Enduring Local Bottleneck was first published.

¹⁶ AT&T offers an unlimited local usage line with two features at a 34 percent discount to Verizon. (Based on HAI research.)

¹⁷ Solomon, Deborah, "AT&T to Offer Free Cable Telephony in Campaign to Hit Subscriber Goals," Wall Street Journal, New York, August 30, 2000.

¹⁸ HAI estimate based on data from the Census Bureau, Rand McNally and AT&T's web site.

Massachusetts today.¹⁹ Deploying cable telephony where it is not available today is an expensive proposition. A recent study estimates that per customer expenditures needed to provision telephone service on an upgraded cable network range between \$590 and \$840.²⁰

24. Even if cable telephony competition were well developed, section 271 relief in the absence of a viable UNE-P entry strategy would not be warranted. Granting section 271 relief in these circumstances would, at best, lead to a mass-market duopoly for Massachusetts local telephone consumers. In other words, the only carriers able to provide consumers with a bundle using their own facilities under these circumstances would be Verizon and AT&T.

25. The inadequacy of a facilities duopoly for ensuring consumer choice can be demonstrated in several ways. As a theoretical matter, duopoly is much more likely to lead to collusion.²¹ Game theory models show that when markets are occupied by a relatively small number of competitors, performance can suffer.²² An increase in the number of firms from two to three or more can have a dramatic effect on prices in these models. In other words, a duopoly in the local or bundled local/long distance services market is not likely to perform competitively. The only near-term way to add competitors to serve residential consumers is through the UNE-P vehicle. Although

¹⁹ As noted elsewhere, RCN is providing residential apartment building service, likely using fiber and DLC rather than cable telephony.

²⁰ See Sanford C. Bernstein & Co. and McKinsey & Co. Broadband, January 2000, p. 89. An upgraded plant is one with 550 to 750 MHz of total bandwidth and an activated upstream path. Upgrading an older system would cost \$196 to \$208 per home passed. *Id.* p. 71.

²¹ Stigler, George J., The Organization of Industry, R.D. Irwin, Homewood, IL, 1968.

²² See, for example, Froeb, Luke and Werden, Gregory, "Simulating Mergers among Noncooperative Oligopolists," Computational Economics and Finance: Modeling and Analysis with Mathematica, edited by Hal Varian (1996).

AT&T allows its cable telephony customers to select any long distance carrier, it is unlikely that AT&T will unbundle cable telephone “loops” or do so at cost-based rates.²³

26. There is also empirical evidence from a telecommunications market that a duopoly does not provide competitive performance. Although incumbent cellular providers argued that prices were competitive prior to entry by PCS carriers, pricing information collected by the FCC demonstrates that prices declined over 50 percent in the five years since PCS entry began in 1995.²⁴ It is reasonable to infer that the increase in competition when the market increased from two to as many as six or seven carriers was dramatic.

27. There would be less concern about a duopoly of facilities-based providers of mass market services if competitors wishing to offer local or a bundled local/long distance service could rely on nondiscriminatory access to unbundled network elements to provide service to their customers. As shown in the next section, the pricing of UNEs in Massachusetts precludes this result.

V. UNE Pricing Precludes Local or Bundled Service Competition

28. In previous section 271 decisions, the Commission has determined that that reasonable availability of the UNE-P provides a sufficient basis for local competition and for long distance carriers to offer their customers a bundled service,²⁵ even though

²³ As has been widely discussed, AT&T has been reluctant for technical and other reasons to provide end-to-end access through its networks even to other ISPs.

²⁴ Before the FCC, In the Matter of Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Service, FCC Document 00-289, Fifth Report and Order, Release August 18, 2000, and Strategis Group, 2000.

²⁵ Before the FCC, In the Matter of Application of SBC Communications Company, *et al.*, Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas, CC Docket No. 00-65, Memorandum Opinion and Order, released June 30, 2000 (“Texas 271 Order”), at para. 5.

evidence was presented showing a lack of significant facilities-based competition.²⁶ The relative lack of facilities-based mass market competition in Massachusetts is not very different from the lack of facilities-based competition in New York and Texas. The difference between Massachusetts and the other two states is that in both New York and Texas the barriers to entry through UNE-P were not completely prohibitive. Section A below discusses the prerequisites for UNE competition. Section B discusses UNE pricing in Massachusetts. Section C compares UNE competition in Massachusetts with New York and Texas.

A. Prerequisites for UNE Competition

29. The provision of local service in any state requires the entrant to incur certain fixed costs, including costs associated with obtaining access from the incumbent and creating systems for ordering, billing, and other functions. If these fixed costs cannot be spread over a large enough customer base in a state, entry will not take place. Thus UNE-P must be commercially viable in a large part of a state, not just for niche customers. The Joint Declaration of Patricia Proferes, John Nolan, Paul Bobeczko, and Thomas Graham [“Proferes Declaration”] filed with WorldCom’s comments in this proceeding discusses the business prerequisites for CLEC entry.

30. For in-region long-distance entry to benefit residential consumers, it is necessary, but not by itself sufficient, that a BOC offer UNE-P. There are two critical requirements for commercial viability. First, the BOC must provision the platform in a

²⁶ Before the Federal Communications Commission, In the Matter of Application of New York Telephone (d.b.a. Bell Atlantic-New York), *et al.*, for Authorization to Provide In-Region InterLATA Services in New York, CC Docket No. 99-295 (“BA-NY Application”), Affidavit of A. Daniel Kelley on Behalf of AT&T Corp., AT&T Exhibit I, October 19, 1999 (“Kelley NY Affidavit”), and In the Matter of Application of SBC Communications Company, *et al.* for Provision of In-Region InterLATA Services in Texas, CC

way that allows CLECs to deliver bundled services to their customers in a reasonable time frame and in reasonable quantities. The mass market customers who competitors need the platform to reach will not be willing to switch unless new entrants can assure them that they will provide reliable service when they promise to provide it – with no interruption of service or billing or other problems. Moreover, mass marketing requires advertising and promotion to large segments of the market. If the new competitor is unable to deliver the service to the retail customer due to the inability of the BOC to provision the UNE-P in sufficient quantities and without delay, then the CLEC will not be able to compete effectively in the local or bundled service market.

31. The second, and equally important, requirement for commercial viability is that the UNE-P must be priced reasonably. That is why cost-based pricing of unbundled network elements is a requirement of the 1996 Act and the Commission's rules. If the BOC were to price the UNE-P at excessive levels, commercial viability could be thwarted just as completely as if unbundled network elements were not available at all. Verizon's pricing of the platform in New York raised serious concerns, several of which were not resolved before the completion of the New York section 271 proceeding. However, because Verizon's retail prices were significantly higher than its UNE rates in New York, the margin allowed competitors to cover their other costs, provide consumers a competitively priced bundled alternative to BOC services, and market these services in a large enough geographic area of the state to make the service viable.

B. UNE Pricing in Massachusetts

32. The price of the platform in Massachusetts is too high in relation to both Verizon's costs and its retail prices to allow effective competition for residential consumers. The Declaration of Dr. Mark T. Bryant ("Bryant Declaration") filed with WorldCom's comments in this proceeding demonstrates that Verizon's cost study is based on unreasonable inputs and assumptions. As a result, the costs in Massachusetts for the platform and switching UNEs in particular are out of line with costs in other states and inconsistent with the Commission's own modeling work. Reasonable adjustments to Verizon's inputs and assumptions result in an 80 percent reduction of port costs and a 63 to 67 percent reduction in local switch usage costs.²⁷ Given retail prices in Massachusetts, the resulting price-cost margins do not allow effective competition using the UNE platform.²⁸

33. UNE loops also appear to be overpriced in Massachusetts. The statewide average is significantly lower in both New York and Texas - \$15.66 in Massachusetts compared to \$14.81 and \$14.15 in New York and Texas, respectively. Loops in the Massachusetts suburban areas where UNE-P competition is likely to be targeted are priced at \$16.12. The equivalent loop prices in New York and Texas are, respectively, \$12.36 and \$13.65. In other words, loops in Massachusetts are between 18 and 30 percent higher.

34. Problems with the pricing of UNEs in Massachusetts are fatal. As noted above, UNE prices that are too high in relation to cost and BOC retail rates can have the same effect on competition as an OSS that does not work. The only theoretical

²⁷ Bryant Decl. ¶ 2.

alternative to UNE-P that competitors have in these circumstances would be to construct their own facilities in order to provide their customers with local service or a bundle comparable to the BOC's. However, as the discussion in Section III above demonstrates, carriers seeking to provide local service in the mass market face barriers to entry and or expansion, and as a result, facilities-based competition for mass-market customers is minuscule in Massachusetts.

35. Reducing UNE prices to the levels required by the Act and FCC rules is necessary, but not sufficient, for section 271 authorization. The best test of the integrity of the OSS is that it is actually handling UNE-P orders in quantities that competing carriers require in order to promote a mass-market service. In both New York and Texas, OSS handled enough CLEC demand at the time of the application to give the FCC an expectation that the OSS could support widescale competition. Since these systems have not been "battle tested" in Massachusetts, and Verizon's Massachusetts systems are different from those in New York, we do not know whether or how they will work when UNE-P demand increases as a result of reasonable pricing.²⁹

C. A Comparison of Massachusetts with New York and Texas UNE Competition

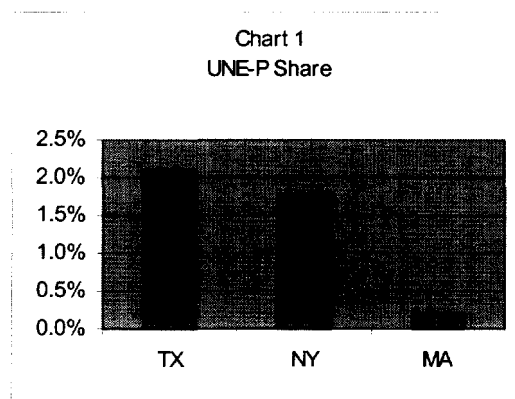
36. The commercial viability of the UNE-P in both New York and Texas could be demonstrated by showing in both states that substantial numbers of UNE platforms had in fact been sold. Moreover, there was continuing growth in the number of platforms being sold. The willingness of CLECs to purchase a significant number of UNE-P does not necessarily mean that UNEs were priced at the appropriate TELRIC rate. What it means

²⁸ Proferes Decl. ¶¶ 24-31.

²⁹ See Kwapniewski Decl. ¶¶ 26-29.

is that in these states the combination of retail pricing, UNE pricing, and UNE provisioning provided a viable market opportunity for CLECs to offer local or a bundled service.

37. As the chart below shows, UNE-P sales in New York and Texas were much more robust at the time that Bell Atlantic and SBC submitted their section 271 applications. In both New York and Texas, the primary purchasers of platforms were AT&T and WorldCom. Neither is actively selling UNE platform service in Massachusetts.



38. Although the actual penetration levels were quite small in all three states, competitors were adding significantly more UNE-based lines than they have been in Massachusetts. For example, in Texas, at the time that the SBC section 271 application was being considered, AT&T was adding a substantial number of platform lines. Between the time SBC filed its initial application and the time it was granted, the total number of UNE-P loops increased from 234,000 to 302,000.³⁰ Similarly, in New York, Dr. Taylor reported that competitors were using 152,055 platforms in the state and that

³⁰ Kelly/Turner TX Declaration, p. 6. and SBC Application, Reply Affidavit of John S. Habeeb on behalf of SBC Communications, February 22, 2000.

“in the past seven months, [competitors] won more than 160,000 customers” using UNE platforms.³¹

39. Granting any section 271 application based on UNE-based competition is inherently more risky where little or no facilities-based local competition exists, especially for mass market customers. The availability, quality, reliability and price of the UNE platform is under the direct control of the BOC, so CLECs and long distance carriers are still dependent on the BOCs for access to their customers. Granting relief under these circumstances requires the Commission to be confident that the BOC applicant has fully implemented the checklist with respect to both provisioning and pricing UNEs (as well as vigilant in post-entry enforcement of the unbundling and pricing requirements of the Act).

VI. Anticompetitive Behavior

40. Dr. Taylor claims that concerns over ILECs engaging in anticompetitive conduct are speculative.³² The discussion above shows that Verizon’s UNE-P prices in Massachusetts are placing CLECs in an anticompetitive price squeeze. Dr. Taylor apparently believes that price squeezes will not occur because they are irrational. But as the late economist Kenneth Boulding once recognized, “anything that exists is possible.” I address Dr. Taylor’s theoretical price squeeze arguments in detail in Attachment 2, where I show that excessive UNE prices, and excessive access charges, will result in a price squeeze for bundled services, which will ultimately reduce the prospects for local competition.

³¹ BA-NY Application, Declaration of William E. Taylor on Behalf of BA-NY, Attachment B, p. 17.

³² See Taylor Decl. pp. 16-17.

41. In terms of the practical effect of Verizon's UNE-P pricing, the rates are set too high to allow WorldCom to provide a competitive bundled service, as shown in the Proferes Declaration. At the same time, as shown in the Bryant Declaration, discussed above, the switching and port rates are substantially in excess of cost. As a result, Verizon has the ability and incentive to set its prices for bundled services at a level that will not permit competitors profitably to provide a bundled service, thereby reducing competition for bundled services and causing prices to be higher and innovation to be lower.

42. Dr. Taylor also uses the experience in New York to argue that Verizon will not discriminate in Massachusetts. Two comments are relevant. First, Verizon has been selling long distance service in New York for only a relatively short time, and it has done so during a period when it intends to pursue multiple additional section 271 applications, in part so it can acquire additional control over Genuity. Verizon's current short-term incentives not to exercise its ability to discriminate are likely to change.³³ Second, as discussed in great detail above, New York is not like Massachusetts. As discussed above, market conditions are such in New York that CLECs are actually able to purchase the UNE-P at rates that allow them to compete.

43. Dr. Taylor also argues that BOC vertical integration into corridor and intraLATA long distance service, cellular, voice messaging service (VMS), and customer

³³ The Commission denied AT&T's complaint even though AT&T documented conduct by Verizon that took advantage of its monopoly position and clearly reduced customer choice. In the Matter of AT&T Corp. v. New York Telephone Company, File No. EB-00-MD-01, Memorandum Opinion and Order (released October 6, 2000). Two Commissioners recognized that this result may reflect a loophole in the Commission's rules, which should be revised to prohibit this anticompetitive conduct (separate statements of Chairman Kennard and Commissioner Ness).